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Overhead per employee

Question

Does anyone have a good working formula for overhead per employee? If you normally have five employees, for example, and your overhead is figured for that, what do you do if you hire two more? You could wait a few months to come up with a new average, but you might lose money without knowing it during that time.

Forum Responses

From contributor D:

There are two ways to calculate overhead. One is to use historical data you've collected and determine what percentage of sales your overhead is. You then use this percentage when calculating your pricing.

The other method is to use an overhead factor, which is to take your actual amount of overhead and recover it through the number of man hours worked on an hourly, daily or monthly basis.

Using either method, if you've added employees, you've probably (hopefully) increased sales and your overhead as a percentage of sales should have gone down. Overhead is a constant, and not likely to change by simply adding a few employees.

Using method one, you would lower the markup percentage that you're currently adding to your bids.

Using method two, you would lower the dollar amount that you attribute to each man hour worked.

From contributor B:

I would like some feedback on this issue too. I tend to disagree that adding employees doesn't add to overhead. Every time we add an employee, we need to purchase more small equipment, insurance, etc.... It's not HUGE, but it is there. What is typically included in an overhead figure? Is this separate from employee benefits (insurance, workers compensation, taxes, 401k, social security, etc.)?

Also, we have a wide range of pay for our cabinetmakers. Do you average the pay to determine a wage rate? Or do you try and break down averages for lead men vs. helpers vs. finishers, etc?

Do you put ALL of your overhead towards employees? We allocate a certain amount of overhead to material markup, and the rest towards "shop burden" on employees.

From contributor D:

You said, "I tend to disagree that adding employees doesn't add to overhead. Every time we add an employee, we need to purchase more small equipment, insurance, etc."

If hiring two new employees requires you to increase the size of your dumpster, or requires you to buy more small tools which you have categorized as an overhead expense, or if you had to hire a new human resources manager for the office, your overhead would go up and you would need to recalculate it. In my shop, however, fluctuations of one or two employees would not affect any of these things or cause my insurance to go up.

You asked, "What is typically included in an overhead figure? Is this separate from employee benefits (insurance, workers comp., taxes, 401k, social security, etc.)?"

I don't offer 401k, so I can't comment on that, but all of the other expenses you've listed are categorized as payroll expenses on my books, not overhead. Therefore, adding or subtracting employees does not affect my overhead.

You asked, "Also, we have a wide range of pay for our cabinetmakers. Do you average the pay to determine a wage rate?"

The wage differences for my shop employees varies by only \$2, so yes, I average their pay rates into one shop rate. Other shops, I believe, charge different rates for apprentice and journeyman cabinetmakers, as you stated.

You asked, "Do you put ALL of your overhead towards employees? What about material markup? We allocate a certain amount of overhead to material markup, and the rest towards "shop burden" on employees."

Our overhead expense is recovered entirely through our shop rate. When I calculate a price, I am determining the amount of materials and the amount of man hours required to perform the job. After calculating this subtotal, I then add a markup for profit, so I am earning equal profit on materials, labor and overhead.

From contributor A:

This works for me, but I can't say it will for you. I define overhead to be the annual costs to be in business, regardless of if someone is working or not. This includes, but is not limited to rent, salaried employees, property and liability insurance, utilities, loans including equipment, property taxes. I do not include hourly employees, workers comp and other employee benefits unless tied to a salaried position because I only assume those costs if an employee actually works. I place these figures in the cost of an hour.

I then take the total cost of my overhead and divide it by the number of hours worked by my production employees. This gives me a cost of overhead per man hour. I then add that to the cost of an employee per hour, then place a markup that I want to make on top. If I add all the employees' costs with markup and overhead in it, then divide by the number of producing hours, that gives me an hourly shop rate to charge. I can adjust accordingly if I want. This works for me as a three-man shop. I can't say it will for anyone else. I don't add materials into the mix because I mark them up individually and they resolve themselves when I buy and then sell them. I don't carry a lot of inventory, so it isn't a static overhead expense.

I think what also plays into this is how people price products. I price based on time, material and expense, for the most part. I don't just mark up materials a percentage and charge that, though some do.

I think it would be interesting to see how people come up with their charge rate and how they take various costs into account in determining pricing. I'm sure a lot of people aren't willing to divulge that information, but I might be willing to post a sample of what I do for conversation and feedback. I'll talk

with my partner and see how he feels about it.

From contributor B:

Contributor A, we have more like 18-20 cabinetmakers/finishers, so changing a couple employees makes a difference, but the additional small tools, insurance, etc. is inconsequential to the decrease in "shop burden" per employee. The larger you get, the less it makes a difference, though! (Adding one employee to a three-man shop will lower the cost/hour more than adding one to a 20-man shop).

Your formula makes total sense. Since we bid a good share of our jobs, we must come up with a material markup that includes profit. We don't have the luxury of our customer paying for our cost of materials. Even so, I think the overhead burden should partially be carried by the material. It takes time to order the materials, space to store them (even short term), and often we're financing the material on a short term (15-20 days) basis.

What do you do about non-productive hours for your cabinetmakers (sweeping the floors, working on equipment, vacation, sick days, etc.)? I looked one year at actual hours logged onto a job vs. available hours and we spent about 15% of our time in the shop on non-job specific work. One year, when we had a very strong growth spurt and spent a huge amount of time adding equipment and space, we spent 23%! Now, that changes your hourly rate! I take that into account when I'm figuring my rates. Do you?

Contributor B, I have kept track of employee hours worked and where. I find that about 20% of total employee time is non-billable. That includes the person's time doing clean-up, tool and shop maintenance, as well as production time. So I use a loaded labor rate that includes all costs, workers comp, taxes that I pay, vacation and such (I used a year's time and costs for calculations). I then mark that up by dividing by .8 to get my average labor cost per hour billable. I then mark up labor and materials to cover overhead and profit. I divide by .6, so 40% of the selling price is to cover overhead and profit. The big question is can I cover my overhead expenses at 25% of my gross sales, leaving 15% for profit.

From contributor U:

In response to the original question, I think we need to look at this from another perspective. The only reason you would hire additional employees is in anticipation or confirmation of additional sales. In other words, additional labor and general expenses do not determine your overhead, but rather overhead determines your labor resources (quantity of employees and rates for employees). More sales require and support it as a percentage of sales.

You cannot let your overhead costs determine your product cost. If you did, your costs would vary from month to month, and so would your prices to keep consistent margins. Builders who build identical homes would not accept differing prices for identical homes. You can, however, determine your target sales level, and then determine your cost of sales and overhead percentage of that sales level. From there, it is a simple matter of making sure you hit or exceed your target sales level, and manage your cost of sales and overhead percentages, making sure they fall within the target ranges. This method answers the questions "Should I hire this employee, and at what rate?" and "Should I purchase this machine, and at what cost?" and many other questions like these.

Net profit is always calculated by taking total sales (throughput) and subtracting cost of sales and expenses, then dividing the sum of these expense categories into total sales. While the means may vary from company to company, since some will include direct labor in cost of sales, and indirect labor in expenses, and yet others will place both direct and indirect labor as an expense, the net profit calculation is still the same, and

for net profit to be consistent, you must manage your sales, and your costs based on the actual sales. Cost of sales kind of manages itself - when sales goes up, cost of sales goes up, when sales drop off, cost of sales drops off. Overhead, on the other hand, only follows this pattern if you manage it well, which you must do.

In conclusion, you must drive overhead to your target level, not let it seek its own level. It's called management, and it's not what most craftsmen desire to do or are good at. We cannot base our overhead on hours worked. Instead, we must base our overhead on anticipated sales, and manage sales to that level or more, and manage overhead to stay within the target percentage of sales.

From contributor A:

Contributor B, our nonproductive hours are rather minimal. Realize that we are a three-man shop, so I come in on a Saturday morning and clean the shop. Since my shop isn't as large as you guys with 20 employees, it only takes me an hour or so at the most. I figure that this Saturday work more than covers the days I take off to sail or golf. Too bad I can't put that in my charge rate.

From contributor L:

I'd like to weigh in here. My overriding rule is that the customer pays for everything. There is no such thing as work hours that are not billable. Any charge that cannot be easily billed to a client has to have an accurate representation as an overhead expense.

I break out my overhead charge into four categories. Fixed overhead for machinery payments, building lease, utilities, taxes, retirement, etc - costs that will be incurred no matter what. Variable overhead for machinery repair, software expense, vehicle upkeep, etc - costs that are incurred on an irregular basis. Salary overhead for the draws against owner's equity (I am a sole proprietorship). And lastly, wage overhead for any employees.

I have tracked these different types of costs long enough to average out a rate per hour for each of the categories. When bidding, each estimate includes the raw material cost, the first three categories of overhead, and last the wage overhead (only if I expect to use employees). All costs for labor are applied against the expected labor for the project. No substitute for experience on that one. This creates a subtotal which I then mark up by my profit margin.

My feeling is that overhead is a quantifiable measurement with no relationship to sales, except as an after-the-fact assessment. I know exactly what my overhead cost is. I have no way of knowing what my future sales are. If overhead is a percentage of sales, your overhead goes down when your sales go down. That would hold true somewhat for wage overhead and a portion of the variable overhead, but the salary overhead and the fixed overhead remain unchanged. In conclusion, my salary and wage overheads are a \$/hour based on historical labor times for my service items. My fixed and variable overheads are a \$/hour based on historical times for project completion. What this has allowed (forced) me to do is to tightly focus my overhead dollars on labor saving expenditures (mostly machinery upgrades) and bring in the wage overhead lastly. My business plan is to have all the machinery in place and paid off so that then I have the flexibility to either hire employees and work the production capacity side, or slow down and take time off because my excess capacity allows me greater throughput. I would appreciate any criticism.

From contributor B:

Contributor U, it seems your method gives the same result. If you do not meet your sales quota, then is your overhead met? If not, then you must be charging more for the same product on slow months.

Are you saying your throughput is exactly the same every month? Whatever formula, an owner must manage overhead, profit AND sales, not just one. In a business that is typically a roller coaster ride of sales volume, I would agree that managing sales is VERY important. But don't be charmed into thinking (at least in custom work) that sales can be managed to a constant level EVERY month.

Every shop must determine a labor rate, and that rate needs to be determined by both historical and current data. The original question concerned how to determine overhead for each employee. That is just as important as managing sales. If you don't know what your overhead is, what do you base sales on?

Most estimating is done by determining labor costs and material costs, then adding the appropriate margins (overhead and profits). If you waited to see what sales would be in the month that job is produced, you would never be able to price a job.

From contributor U:

Contributor L, you stated: "My feeling is that overhead is a quantifiable measurement with no relationship to sales except as an after-the-fact assessment. I know exactly what my overhead cost is. I have no way of knowing what my future sales are. If overhead is a percentage of sales, that would mean your overhead goes down when your sales go down."

If I understand your reasoning, if your overhead is \$6000 per month, and you do four jobs this month – each with a customer cost before overhead of \$10,000, to which you add \$1500 each as overhead - then what happens next month if you only do three jobs, each with a customer cost before overhead of \$10,000? Do you add \$2000 to each as overhead? What if you were only to do one job all year - does that client bear the burden of your entire overhead for the year? I know that is an exaggeration, but it seems that by having a fixed overhead dollar figure, that it would have to happen that way. It just seems to me that either your overhead fluctuates with sales (which forces one to focus on sales, which is an infinite number, and ultimately increases net profit since it is also a percentage of sales), or it is a fixed amount that on bad months is not covered, and can never be recovered (which forces one to focus on expenses, which are finite numbers that can only be reduced so much, and can never be zero).

I suppose I don't understand how it is that you apply this fixed overhead number to a job. Is it applied based on the time it will take to manufacture? Is it based on the number of jobs you will do in a given month? If so, is there no relationship between the total sales for the month and the overhead applied?

If you apply overhead based on your labor (which seems to be what you are saying), then when you have a bad (low) sales month, you do not recover all of your fixed overhead. The same holds true of an overhead based on a percentage of the sale, but in the percentage of the sale method, you recapture some of this on your good (high) sales months. Many times you actually recover much more than you lost on your bad or low sales months.

Maybe if you answer this question, I will better understand how you're applying your overhead. Would two identical jobs always cost your customer the same amount, even if they were done 3 or 4 months apart?

Contributor B, you stated: "It seems your method gives the same result. If you do not meet your sales quota, then is your overhead met? If not, then you must be charging more for the same product on slow months."

It depends on how the overhead is applied at the estimate stage in his method. If it is based on man-hours, then yes, it should work very much the same as a percentage of sales, because it actually becomes a percentage of labor, which if the man-hours are predicted correctly each time, then

identical jobs will cost the customer the same amount. If, however, he calculates his material and labor, then applies a flat overhead fee to each job based on how many jobs will be run that month, the cost to the customer will vary depending on the workload for the month. The danger in the overhead being applied based on labor is some jobs have very little labor, and very expensive materials. You simply get a more consistent result by applying overhead based on both material and labor rather than one or the other.

You asked: "Are you saying your throughput is exactly the same every month?"

No, my sales level is not the same every month, but there are a lot less months that dip below my target sales level since I began to understand that the most devastating thing I could do to net profit was to not sell enough to cover my costs (better said, not know my break-even point, and stay above that point). Typically my sales are much higher than the level my overhead was based on, which means that the overhead converts to additional profit. One of the reasons that my sales are higher than my target level is because I have learned to focus on sales (infinite, can be anything I desire) rather than costs (finite, can only be reduced so much), and since net profit is a percentage of sales, the higher the sales, the higher the net profit if overhead and cost of sales moves proportionately.

You also stated: "Whatever formula, an owner must "manage" overhead, profit AND sales, not just one. In a business that is typically a roller coaster ride of sales volume, I would agree that managing sales is VERY important. But don't be charmed into thinking (at least in custom work), that sales can be managed to a constant level EVERY month. Every shop must determine a labor rate, and that rate needs to be determined by both historical and current data. The original question concerned how to determine overhead for each employee. That is just as important as managing sales. If you don't know what your overhead is, what do you base sales on?"

I answered the original question by saying that I don't think that overhead should be based on employees, per employee, or per man-hour. I know what my overhead is, and based on historical data, obtained from a simple profit and loss statement, I can apply that overhead percentage of past sales to future sales (estimates and proposals) with confidence that if I sell the same amount next year, I can expect at the very least, the same results this year, and if I sell more, the additional overhead converts to additional profit - my reward for being diligent, knowing my costs, and managing my sales level (I have not been charmed into managing my sales level, I have just been rewarded financially for doing so, and will choose to continue doing so). Anytime I can focus on one item instead of three (I did not say ignore the other two), I feel my chances of success are better.

You stated: "Most estimating is done by determining labor costs and material costs, then adding the appropriate margins (overhead and profits). If you waited to see what sales would be in the month that job is produced, you would never be able to price a job."

As I have already stated, the overhead PERCENTAGE is based on historical data (last year's overhead as a percentage of sales). Once the percentage is determined, it is simply applied to each estimate or proposal as a percentage of the sale, just like net profit. Once you have determined your material and labor cost, you add all the appropriate markups (all percentages) for sales commission, design fee, engineering fee, overhead and profit. This makes two identical jobs cost the same thing every month, regardless of sales level. If the method you are using produces the same price on two identical jobs, then we are arguing about details that are meaningless. If the method you are using produces different prices for two identical jobs, then you are in a very different place, and you must understand that when sales decrease, your prices increase, which could possibly produce even less sales.

From contributor B:

Contributor U, I think we're saying the same thing, we're just getting there in a little different way. To me, the most important idea you're presenting is that your markup should be based on the slowest month in sales (or the dips). In our business, our jobs overlap and it is impossible to know a monthly sales volume until you're right on top of it. We have certain jobs that bid a year before we produce them and others that are fast track. They all overlap.

I can't agree with you more that sales are crucial in making sure you meet overhead. In my opinion, sales (or lack of) are often what kills people in our business. More importantly, they fall into the cycle of realizing they have no sales, then undersell work to meet overhead. They fall behind, then never recover.

I also completely agree that overhead must be spread between BOTH labor and materials. Whatever formula is correct is debatable. More important is that you use a formula (and I think a great number of smaller shops are just guessing).

From contributor D:

Contributor U, after reading your posts, I wanted to clarify something. As you know, I believe in recovering my overhead through labor, or through the amount of time a project spends in the shop. I do not recover overhead through materials because of the unusual price fluctuations this can cause that customers don't understand, an issue that we already covered on your forum.

You seem to think that if I have a slow sales month, I am somehow less able to recover my total overhead expenses using factors than you are using percentages.

Your percentage is based on an annual overhead amount averaged over 12 months. You rely on good months to balance slow months. My factors are also based on annual overhead averaged over 12 months, and I also rely on good months to balance slow months. The overhead rate that I attach to every man hour worked is loaded to account for those slow months, just as your percentage is loaded.

You maintain that if I have a slow month and am not able to recover my overhead through man hours, I will not have the opportunity to catch up. This is no truer than if you had a slow month. If you or I had no sales for a year, neither of us would be able to cover our overhead.

From contributor L:

In reply to contributor B's questions... For me, overhead is always a fixed amount. I recalculate my overhead 3 to 4 times a year to keep on top of any changes. It is absolutely not covered on bad months. Nobody's overhead is covered on bad months. In fact, I think that is the definition of a "bad" month. Overhead is recovered in the good months, but the "good months" translate into higher volume months.

That is why I believe that machinery is a better utilization of overhead dollars than employees are. Machinery responds to an increased workload much more efficiently than employees do.

I apply overhead to a job based on the total time estimated for the project. That includes the layouts, machining, material handling, cleanup, site involvement (multi-level houses, number of miter joints, pita contractor, finished floor, cut in boxes, toe kick heat registers, etc). The total time is something that only experience can teach you.

My formula for estimating is (MATERIALS) + (SHOP RATE) X (TOTAL

$$\text{TIMES FOR ALL SERVICE ITEMS} + (\text{OVERHEAD RATE}) \times (\text{TOTAL JOB TIME}) = \text{JOB COST OF PRODUCTION. JOB COST OF PRODUCTION} + \text{THE DESIRED MARKUP AMOUNT (true profit)} = \text{JOB ESTIMATE.}$$

By keeping the desired markup high enough to cover the bad months, each individual customer is amortizing a completely fair and just amount of the shop overhead as they should be. After all, I don't have all this machinery to manufacture products for myself. Whenever someone comes into the shop and says, "You sure have all the toys" I look them right in the eye and say "THESE ARE NOT TOYS!" (translation – "You are paying for them").

I use a burdened labor to account for overhead cost also. I can see contributor U's point, but we (10 man custom res.) do raise our price to compensate for slow sales. I have found that lowering my price to increase sales when we are slow only ties us up with less profitable work and has cost us some opportunities for work that would have moved us forward financially. Part of managing sales, to my thinking, is pursuing the projects which most fit your circumstances. This strategy, of course, only applies to our business, which is custom residential and mostly remodel and in which we control the point of sale (no contractors, designers, etc.) I apologize for getting to far off topic but conversations about overhead factoring must eventually address sales and marketing.

From contributor A:

I am assuming, based on the content only, that most of you guys have fairly decent size shops. I guess it only reassures me to stick to the 3-4 man shop size. My fixed overhead changes minimally each year. It is changed by interest rates more than anything else. I cover my overhead in my charge rate. So if my guys work their 40 hours and meet their productivity rate, I'm beating my budgeted margins.

I guess what I find interesting is that many participating in this discussion must work on very tight margins - that is, if overhead plays that big of a role to be profitable. Don't get me wrong. I'm not minimizing the importance of overhead, but it is a minor figure in my business compared to things like labor and materials.

When I review my pricing structure each year I tend to look more at my productivity rate, cost of materials and cost of labor. I think that materials drive my price increases more than anything else, and even then I often am able to recapture that throughout the year by negotiation.

From contributor B:

In our 25 man shop, overhead is a huge part of our business. I'm not sure where we stand in comparison to other shops, and would like to know. But, even if I knew, it would not matter. We have to recoup those costs in what we charge.

In our business (custom architectural woodwork), the estimator plays a huge role in rather we make money or not. Since each of our projects is different, it is impossible to have good time studies.

Some things are always different on a job (material, details, finish, customer, etc.) and it is really an educated guess as to how much labor it will take to complete a job.

It is my feeling that this guesstimation is where most of our competition fails. We see so many shops go in and out of business - it's just crazy. Our competition seems to be from two schools:

1- Previous unrelated business owner who knows nothing about custom woodworking and thinks buying a bunch of equipment is the right answer. They then bid work not knowing that there's a great deal of the custom side

of work that simply can't be done with equipment (or if so, the equipment can't be justified).

2- The passionate cabinetmaker who loves what they do, and thinks they'll make a go of it on their own (hey, the boss plays golf once a week and must be making a ton of money - it can't be that hard). They don't understand the money side of it and underbid work. They usually base their bids on "I could have done it that fast", not realizing their employees won't be as motivated to work as hard as he might have been.

I'm just trying to be a little of both (only the best of each).

From contributor U:

Contributor A, my company consists of two full time employees and myself. My typical net profit is between 28% and 32%

Contributor B, my typical overhead runs between 15% and 18%.

I use an Excel spreadsheet to forecast what the income-expense scenario needs to be to make it pay when I want to add an employee.

It helps to have a few years going back of accurate year-end accounting information.

I set up a labor spread showing each employee, existing and proposed, the hourly rate they make x regular hours, plus overtime hours (on an average basis), etc.

I plug those totals over to an income-expense spread that basically resembles a standard monthly income statement showing sales, costs of production, and general expenses. The scenario works off of yearly income and expenses, so you are not concerned with monthly trends that are not predictable.

Most expenses are either fixed, or they change on a percentage basis. For instance, payroll taxes are a fixed percent of labor cost. Some costs increase as production increases. If material costs are not predictable on a *yearly* basis, run your scenario without these costs, since you are going to charge appropriately on a job by job basis.

Essentially, I have a spread where I can plug in any number of new employees, plug in wage-hours or salary, etc. The spread calculates automatically what this does to the bottom line. Then I adjust the income goal to the amount necessary to achieve desired profit. Set a weekly production goal average and keep your eye on it. Oh, and before you hire, don't forget to ask yourself if you are sure you can sell this much business consistently to meet the goal.

This has been a great tool for me. In earlier years, I would add employees as backlog increased, not knowing what my production needed to be. This is a recipe for an illusion of success that really only amounts to you working harder while losing your butt.

The comments below were added after this Forum discussion was archived as a Knowledge Base article ([add your comment](#)).

Comment from contributor C:

I think there is a lot of confusion on costing. The first step is to get with your bookkeeper or accountant and truly understand your fixed and variable cost structures. Also, understand capital expenditures (amortization) versus expensed items. Much of what is discussed is relative to basic accounting principles.

The other critical point to understand is historical costing and actual costing. In a job shop environment you should be looking at actual costing methods always. One contributor mentioned he used a spreadsheet - yes, this is a great tool. Develop your formula for fixed overhead, labor rates inclusive of variable overhead for different aspects of a given project, your material markup and most important use waste factors and variance factors. Apply those to both time and materials. Cost your project using the time and material rates as close as possible to the actual estimated process. Then add your fixed overhead rate plus profit. This will give you a good estimate. Now measure your project as it is completed against your estimate. Most importantly, do your historical analysis and adjust your factors accordingly. Over time you will develop a very accurate costing model for your business and review it with your accountant or bookkeeper whenever possible. Estimating is a science and an art. I always recommend a good accountant audit or review of my methodology. If sound, it will be a solid framework for your business.

This whole discussion starts with adding an employee(s) - labor is a variable and equates to hours expended. Labor is typically not a fixed cost - though if you have order entry people or customer service it can be part of your G&A cost structure and then is a fixed indirect cost. Understand the difference between indirect and direct labor - this will help you develop a better understanding of costing principles. Develop percentages for employee benefits - add this to your base variable labor cost. This will then get applied equitably via billed hours. Don't markup labor - use variance factors as your tool. Variances are historical data - the more detail you track per project the more accuracy you'll bring to your costing model. Have the discipline to run labor and material sheets in your shop on all projects. Collect and input daily - track every aspect possible on a project.

Always remember you should be able to explain your methodology to your customer and it should seem fair - you do need to compete in the market.

Comment from contributor P:

For our company, overhead per employee or employee hour is something I have never considered. It may be helpful to understand this ratio in considering the overall health of our company, but I don't think we would ever consider it in determining the rates we charge or estimate, which are always determined by what the market will bear.

We view our overhead from a different perspective: 1. What is the appropriate overhead expense as a percentage of our annual gross receipts with static growth? 2. By what amount or percentage can our overhead exceed that generically-imposed appropriate percentage as an investment in growth? In short, how much can we afford to invest in the buildup of our company, with its roots in increased sales, and development of our ability to perform the associated increased work?

This can be a very difficult issue to grasp and manage and I have been very focused on it recently. When I brought these issues up to our internal financial people and our accountant, I was amazed at how unprepared they all were. They were unprepared because all of their discussions were about payroll, workers comp, taxes and credit - the urgent stuff.

It is clear from speaking with my staff and reading these articles that everyone has a different concept of what constitutes overhead and what percentage of annual gross receipts overhead should be.

I have asked our controller for an analysis of our overhead defined as all expenses other than direct site expense or cost of goods sold.

Workers compensation is not overhead, except as it applies to office staff, because it is a component of payroll tax on labor, which is a direct site expense.

Liability insurance is a variable cost under overhead, since it increases as a dollar amount with sales, though it shouldn't change much as a percentage.

This discussion and these definitions are as important to me as cost accounting and, in fact, I consider them together: How much do we make on our jobs, how much must we retain to keep it safe, and how much must we invest in staff, software, training and estimators to allow me to go out and sell.

To know fixed overhead is one thing, but to manage discretionary variables within overhead is what it is all about, because sales and profits vary and we must tool up and down in the office as well as in the shop and field while continuing to realize growth overall.

I need to know at all times what amount of our overhead is overhead and what is capitalization of growth, and I wish someone would tell me what percentage of gross receipts overhead should be, but I would never base my prices on it.

We all know twenty contractors who charge 10% profit and 10% overhead, but do we know any whose overhead is actually 10%? No, we don't.

Have you reviewed the related Knowledge Base areas below?

- [KnowledgeBase: Business](#)
 - [KnowledgeBase: Business: Estimating/Accounting/Profitability](#)
 - [KnowledgeBase: Business: Project Management](#)
 - [KnowledgeBase: Business: Sales](#)
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